

Recession opportunities: Compliance with charity care obligations and maintaining tax exempt status

by Paul R. DeMuro, C.P.A., M.B.A., J.D., CHC, Julie S. Marder, J.D. & Robert C. Levels, J.D.

As more patients become uninsured and underinsured during these difficult times, revenue pressures may tempt hospitals to restrict their charity care policies. Taking this action, however, may merely transfer what could have been charity care into bad debt, with the result that nonprofit hospitals may have more difficulty justifying their tax-exempt status. Instead, compliance officers may be able to convert certain bad debts into charity care. This article explores the competing considerations for developing and administering charity care policies, highlighting opportunities to ensure compliance with charity care obligations and maintaining tax exempt status given the increase in the number of patients who cannot pay for medical services during the economic downturn.

Defining Charity Care and Bad Debt

The term “uncompensated care” refers to any care provided for which a hospital does not receive payment, which includes both charity care and bad debt.¹ “Charity care” and “bad debt” tend to be defined inconsistently. Sometimes the terms are defined broadly: charity care is any free or discounted care provided to patients with demonstrated inability to pay, while bad debt arises when patients capable of paying their medical bills fail to pay.² Other definitions focus on the provider’s expectations: charity care is granted without any expectation of payment, while bad debt arises when a hospital expects to be paid but has been unable to collect.³ Hospitals may also choose to provide discounts for uninsured patients, prompt payers, or low-income individuals who do not qualify for charity care. These discounts will amount to uncompensated care, but they cannot be considered charity care for tax exemption purposes.⁴ For tax exemption purposes, charity care must be provided pursuant to a policy that identifies financial need. The Internal Revenue Service (IRS) and the Centers for Medicare and Medicaid Services (CMS) afford hospitals wide latitude to craft policies to determine financial need.

Charity Care and Federal Tax Exempt Status

Nonprofit hospitals comply with their federal tax exemption obligations by providing “community benefit.”⁵ Charity care is just one type of community benefit, and nonprofit hospitals are not required to provide any set amount of charity care. Yet, leaders seeking to reform the community benefit standard, such as Senator Charles Grassley (R-Iowa), often look to charity care as an indicator of whether a nonprofit hospital should be able to maintain its federal tax exempt status.

¹ Heather O’Donnell & Ralph Martire, Center for Tax and Budget Accountability, An Analysis of the Tax Exemptions Granted to Cook County Non-Profit Hospitals and the Charity Care Provided in Return at 9 (2006).

² Healthcare Financial Management, P & P Board Statement 15: Valuation and Financial Statement Presentation of Charity Care and Bad Debts by Institutional Healthcare Providers at 1-2 (2006).

³ Congressional Budget Office (CBO), Congress of the U.S., A CBO Paper: Nonprofit hospitals and the Provision of Community Benefits at 2 (2006).

⁴ Healthcare Financial Management, *supra* n. 2 at 7.

⁵ O’Donnell, *supra* n. 1 at 6-7.

In 2006, the IRS began to study in depth community benefit and executive compensation practices and reporting of nonprofit hospitals.⁶ The resulting report, released in February 2009, highlights the prominent role that uncompensated care continues to play across the nation. In evaluating the amount of uncompensated care provided as a percentage of nonprofit hospitals' total revenues, the study found that, on average, nonprofit hospitals dedicated 7 percent of their revenue to uncompensated care (median is 4 percent). Moreover, uncompensated care accounted for 56 percent of the community benefits provided by these hospitals. When research hospitals were removed from the sample population, uncompensated care accounted for 71 percent. With no shortage of uncompensated care in sight, this study suggests that nonprofit hospitals should have little trouble meeting the federal community benefits standard for tax exemption.

As the IRS noted, however, the study is limited because respondent hospitals had a great deal of discretion in determining which activities would be considered a community benefit and how the value of those activities would be measured. Indeed, a vast array of activities may qualify as community benefit for federal tax exemption purposes, but in many states, only charity care appears to qualify a hospital for state and local tax purposes. Thus, while a hospital may be tempted to restrict charity care during the economic downturn, doing so may inadvertently place state and local tax exemptions at risk. Accordingly, this study underscores the great opportunity that nonprofit hospitals have to convert much of their extensive uncompensated care into charity care to better position them to meet the expectations of the federal, state, and local officials with respect to the provision of charity care.

State and Local Tax Exempt Status and Greater Charity Care Obligations

State and local tax exemption laws vary widely across the country, many imposing more burdensome obligations than the federal government. For example, to qualify for state property tax exemption in Utah, hospitals must not only meet the federal tax exemption standard, they also must engage in some "act of giving," such as the provision of charity care. In Texas, property tax exemption is contingent upon meeting reporting requirements and specified quantitative standards. In Illinois, the standard for sales and property tax exemption is not merely a general provision of community benefits, it is a specific requirement to provide charity care to all who need it.⁷ Meeting this difficult charity care standard is critical for Illinois hospitals because sales and property tax exemption is particularly valuable in Illinois. In Illinois, sales and property tax exemptions constitute approximately 96 percent of the value of all tax exemptions received by hospitals,⁸ whereas this figure is only approximately 50 percent nationally.⁹

Class Action Law Suits Impose Charity Care Obligations

Decisions and settlements from class action lawsuits may impose additional obligations to provide charity care. In 2004 and 2005, a series of lawsuits were filed across the country, alleging that certain nonprofit hospitals overcharged uninsured patients or provided too little

⁶ IRS Exempt Organizations (TE/GE) Hospital Compliance Project Final Report, Feb. 2009, available at: <http://www.irs.gov/pub/irs-tege/frepthosproj.pdf>.

⁷ CBO, *supra* n. 3 at 5.

⁸ O'Donnell, *supra* n. 1 at 2.

⁹ CBO, *supra* n. 3 at 3.

charity care.¹⁰ Many of these class actions settled and, as part of the settlement agreements, hospitals committed to certain levels of discounted and charity care. Some of these class action suits are still being resolved, but recently, many new claims have been dismissed and motions for class certification have been denied. As a result, hospitals may now be less susceptible to new litigation regarding charity care, but they may be legally bound by obligations from settlement of past claims against them.

Compliance Issues to Consider in Re-Evaluating Charity Care Policies

Given the current economic downturn, a hospital may be forced to provide increased amounts of uncompensated care, regardless of its charity care policy. As more patients become unemployed or underemployed, more patients will become uninsured or underinsured, and they are more likely to be financially incapable of paying their medical bills.

If uncompensated care is increasingly inevitable, it may be beneficial for hospitals to provide this care as charity care, rather than allowing it to become bad debt. With the exception of Medicare patients for whom government reimbursement of bad debt is possible, increasing levels of defaulted medical bills will only hurt both the hospital and the patients. The hospital will be forced to give away uncompensated care, but it will not receive the benefit of counting this towards complying with its charity care obligations. Additionally, patients with no hope of making payment will be forced to endure the collection process, harming both the patients and economic recovery efforts. Moreover, as local press publicizes these patients' unpleasant experiences, the hospital's relationship with its community suffers. Thus, the hospital may benefit from including as many low-income patients as possible in its charity care program.

Compliance officers should consider the following issues when evaluating their charity care policies in light of the current recession. These issues are based on commentators' observations of charity care policy¹¹ and an informal review of individual charity care policies from hospitals across the country. Because a part of tax exemption requirements for charity care are dictated by state and local law, and because extensive variation exists among these laws, it will be important to review one's state and local laws governing charity care obligations before employing the charity care policies of out-of-state hospitals for guidance. Moreover, hospitals also should evaluate each of these issues in light of the needs of their individual institutions and the communities they serve.

1. Notice of charity care policy. In addition to measures already taken to post charity care notices conspicuously within the hospital, charity care policies and applications should be conspicuously posted on the hospital's website. Hospitals that clearly and simply explain their charity care policies on their websites may gain an advantage in attracting charity care applicants. Yet, a surprisingly large number of hospital websites simply tell patients to call a financial counselor for information. With so little information provided online, patients may not realize that they are eligible for free or discounted care and, in that case, they will not take the additional step of calling during a workday for more information. In contrast, some hospital

¹⁰*Hospitals: California Court Approves Final Settlement in Catholic Healthcare West Uninsured Case*, BNA's Health Law Rep., Jan. 18, 2007.

¹¹ Healthcare Financial Management Ass'n, Patient Friendly Billing Worksheet for Reviewing Financial Assistance Policies (2005); Healthcare Fin. Mgmt., *supra* n. 2.

websites not only describe their charity care policies online, they allow patients to apply for charity care online. Other hospitals provide convenient tools such as “charity care calculators” that allow patients to predict how much charity care they may be qualified to receive.

2. When to apply? Ideally, hospitals will assist patients in applying for charity care as soon as is practical. Many charity care policies require patients to be reminded about the availability of charity care at various points throughout the patient experience. Patients could be asked to apply for charity care upon scheduling their appointments, upon registration, at the point of service (or stabilization for emergency patients), in each bill, and in some states, even after a collection action has commenced. In addition, hospitals may consider including charity care applications in their standard registration form packet. When registration staff learns that patients are uninsured, they may ask those patients if they are interested in applying for discounted medical care. If the patient responds affirmatively, registration staff could provide that patient with a registration packet that contains a charity care application in lieu of an insurance information form.

3. Flexible application deadlines. It may be advantageous to build flexibility into a hospital’s charity care policy to ensure that charity care determinations can be reconsidered in certain circumstances. For example, especially in light of the currently turbulent economy, hospitals can emphasize that charity care determinations may be re-evaluated upon dramatic changes in financial status. Moreover, hospitals may want to consider charity care applications even after collection has commenced. Allowing patients to apply for charity care at this late stage may enable hospitals to convert bad debt into charity care. Indeed, some hospitals take the initiative to convert bad debt into charity care *vis-à-vis* late stage re-evaluation, even if a patient fails to complete a charity care application. Such hospitals refer to publicly available information, homeless status, Medicaid enrollment, or even credit reports to support their decision to award charity care. When analyzing these options, however, compliance officers must be careful to consider state law restrictions on the deadline for determining charity care. According to some commentators, qualification for charity care must be determined prior to billing to count towards certain states’ tax exemption laws.¹² Other commentators encourage hospitals to continue screening for charity care patients throughout the revenue cycle.¹³

4. Making charity care appealing in a down economy. While “charity care” appears to be the accepted term of art hospitals use internally, compliance officers should consider adopting a more neutral public name for their policies. Especially in light of the current recession in which many hardworking individuals find themselves suddenly unemployed or underemployed, potentially qualified patients may shun the idea of receiving any form of “charity.” Thus, by referring to a charity care application as one for “discounted medical care” or something equally judgment free and including the application among a patient’s routine admission paperwork, hospitals may increase participation in their charity care programs.

5. Sliding scale. Allowing a hospital’s charity care sliding scale to be adjusted periodically in light of changing social and economic conditions, assuming this is not a contravention of any settlement or other agreement, may help the hospital to better ensure compliance with its charity

¹² O’Donnell, *supra* n. 1 at 9.

¹³ Healthcare Financial Management., *supra* n. 2 at 5.

care obligations. This is particularly true during a recession. Given the increasing loss of jobs and loss of health insurance, growing numbers of patients will likely qualify as indigent or medically indigent. Instinctively, hospitals may assume that decreasing their sliding scales so that fewer patients will qualify for charity care would reduce hospital spending and increase revenue. While such a policy would control the number of charity care patients served, it may do nothing to control that an increasing proportion of the patient mix will be less able to pay their bills. As outlined above, it will likely be in a hospital's best interests, from both compliance and public relations perspectives, to embrace these struggling patients as part of its charity care program, rather than lose them to bad debt. Depending on the needs of the community and available resources, hospitals might even consider increasing the values of their sliding scale so that more patients may qualify for charity care.

Considerations When Reducing the Amount of Charity Care

If a hospital ultimately decides that it must curtail its charity care policy, however, the following compliance issues should be considered:

- Does the state in which the hospital is located establish a minimum level of charity care that nonprofit hospitals must provide?
- Has the hospital been involved in a class action suit in which the cost of medical care was at issue? Many such class action settlements result in binding obligations to provide discounts and charity care at a particular level. Be sure that any contemplated decreases in charity care do not violate the terms of these settlement agreements.
- Has the hospital or network made representations on publications or websites regarding the charity care that the hospital will provide? Be sure that any contemplated decreases in charity care do not violate the expectations that such representations may have created.

Conclusion

Although current financial strain may tempt hospitals to scale back charity care policies in attempt to preserve revenue, hospitals should look at this recession as unique opportunity to expand the provision of charity care. By responding to economic hardship with generous charity care policies, nonprofit hospitals may convert inevitable bad debt into charity care that will benefit the hospital's patients and preserve the hospital's tax exempt status.

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Paul R. DeMuro is a partner in the Los Angeles and San Francisco offices of Latham & Watkins LLP. He is a CPA with an MBA in finance who has practiced corporate and health care law since 1979. Mr. DeMuro has practiced extensively in the areas of corporate transactions, joint ventures, mergers and acquisitions, corporate organization, governance, finance and regulatory compliance. He works with hospitals, health plans, e-health and health care technology companies, medical groups, physician practice management companies and integrated delivery systems. He also practices in the areas of Medicare reimbursement, fraud and abuse,

compliance and managed care. He is a member of the CCH Health Care Compliance Editorial Advisory Board. Mr. DeMuro can be contacted at paul.demuro@lw.com.

Julie S. Marder is an associate in the Chicago office of Latham & Watkins, LLP. She practices both general corporate law and litigation, with a focus on the healthcare industry. Prior to joining Latham & Watkins, Ms. Marder served as a Clerk for the Honorable Justice Ayala Procaccia of the Supreme Court of Israel.

Robert C. Levels is a litigation associate in the Chicago office of Latham & Watkins, LLP. Since joining Latham & Watkins in 2005, Mr. Levels has gained litigation experience in both US federal and state courts, focusing on consumer class actions, complex commercial litigation and securities cases.